STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company Proposed General Increase in Rates for Gas Service	: : : :	Docket No. 11-0280
The Peoples Gas Light and Coke Company Proposed General Increase in Rates for Gas Service	: : :	Docket No. 11-0281

Rebuttal Testimony of
Scott J. Rubin

on Behalf of
the People of the State of Illinois, the Citizens Utility Board,
and the City of Chicago

GCI Exhibit 8.0

August 15, 2011

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Introduction

Q. Please state your name.

A. My name is Scott J. Rubin. I previously filed direct testimony in this case, labeled GCI Ex. 3.0.

Q. What is the purpose of your rebuttal testimony?

A. I respond to portions of the rebuttal testimony filed on behalf of North Shore Gas Company ("North Shore" or "NS") and the Peoples Gas Light and Coke Company ("Peoples Gas" or "PGL") (collectively, the utilities are referred to as "NS-PGL" or the "Companies") witnesses Grace (NS-PGL Ex. 28.0) and Hoffman Malueg (NS-PGL Ex. 29.0).

Response to NS-PGL Witness Grace

Q. Ms. Grace criticizes your calculation of residential (SC 1) demand costs per therm. Do you agree with her?

A. I agree with some of Ms. Grace's revisions to my calculation of SC 1 demand costs per therm. I do not agree with her policy-based criticisms.

EPEC Methodology

Q. Ms. Grace criticized your calculation of SC 1 demand costs because you did not consider the EPEC methodology. Is she correct?

A. Yes. Ms. Grace correctly states that my initial calculation of the demand cost per therm did not reflect the EPEC methodology that the Commission has adopted for the Companies for the past several cases. This methodology has the effect of reducing the recovery of costs from the residential class to 98.6% of the amount shown in the embedded cost of service study ("ECOSS").

Annual vs. Winter Consumption

Q. Ms. Grace suggests that your calculation should have divided demand-related costs by total annual consumption, not winter consumption. Is she correct?

A. I do not agree with Ms. Grace's theory, but for purposes of this case I am willing to accept her methodology that would spread SC 1 demand-related costs over all volumes of gas sold to SC 1 customers during the year. Later in this testimony, I show the effect of this and other changes on my recommended SC 1 rate design.

Storage-Related Costs

Q. Ms. Grace also states that you did not consider the Companies' proposal to recover storage-related costs through proposed Rider SSC in your calculation of the per-therm distribution charge. Is she correct?

A. Not entirely. I was well aware of the Companies' proposal to establish Rider SSC, however, I did not explicitly reflect that proposal in my calculation of the per-therm distribution charge. There are two important aspects to this issue that Ms. Grace did not fully discuss or consider in her rebuttal testimony and exhibit.

First, proposed Rider SSC correctly shows that storage-related costs are, in fact, related to the amount of gas that a customer uses – even though, as I explain below, Ms. Grace improperly considered such costs to be "fixed" in her direct testimony (PGL Ex.

12.5 and NS Ex. 12.5) and in her rebuttal. Thus, proposed Rider SSC properly recovers those costs from SC 1 customers on a per-therm basis.

Second, Ms. Grace's exhibit does not reflect the proper amount of credit for storage-related costs. On NS-PGL Ex. 28.1, line 18, Ms. Grace shows a credit of $24,105,264 for Peoples Gas and $1,232,920 for North Shore for costs that would be recovered under Rider SSC. But the Companies are proposing to recover substantially more than this amount through Rider SSC. Peoples Gas is proposing a charge of $0.04673 per therm for Rider SSC, which would recover $30,028,000 in revenues from SC 1 sales customers. PGL Sch. E-5, Section B, page 1, line 10. Similarly, on North Shore Sch. E-5, Section B, page 1, line 10, North Shore shows that it would impose a charge of $0.00884 per therm that would recover $1,508,000 from SC 1 sales customers under Rider SSC. Thus, either the Companies have greatly over-stated the proper amount of costs to be recovered through Rider SSC or Ms. Grace has under-stated the credit in her calculation of demand-related costs per therm.

Uncollectibles

Q. Ms. Grace criticizes your proposal to recover uncollectibles from SC 1 customers through a percentage increase in all charges. How do you respond?

A. I am not certain that Ms. Grace has fully understood my proposal. I did <u>not</u> propose a change in the way the cost-of-service study allocates uncollectibles to the customer classes; I simply made a rate design proposal limited to SC 1 customers. I apologize if my testimony was less than precise in this regard, but I will try to be clearer now. I am not suggesting any change in the way uncollectibles are allocated among customer classes. My proposal is limited to the way in which the residential class's share of those costs is recovered from SC 1 customers.

Specifically, just as the Companies are proposing to recover uncollectibles related to the cost of gas through a per-therm charge, I am recommending that a portion of SC 1 base-rate uncollectibles also should be recovered on a per-therm basis. As I explained in my direct testimony, there is tremendous diversity within the SC 1 class, and it is unfair to small customers to have to pay the same dollar amount for uncollectibles as very large SC 1 customers pay. Instead, such costs should be shared among all SC 1 customers in proportion to the base rate portion of their bills, just as the Companies are proposing to share gas-cost-related uncollectibles in proportion to the gas-cost portion of SC 1 customers' bills.

Administrative and General Expenses

Q. Is there a similar misunderstanding over your proposed treatment of administrative and general ("A&G") costs?

A. Yes, I think that Ms. Grace also misunderstood this aspect of my proposal. First, with respect to the reallocation of A&G operations and maintenance ("O&M") expenses, I think the language I chose was less than precise. Once again, I am not proposing a reallocation of costs among the customer classes; my proposal is limited to the design of SC 1 rates.

Q. Is there a way to simplify your proposal?

A. Yes, in the interests of trying to simplify the issues in this case and reduce some of the controversy, I will withdraw my proposal to treat some A&G O&M expenses as demand-related costs within the SC 1 class.

Q. Does that change your proposed treatment of customer-related A&G costs in the design of SC 1 rates?

A. No, it does not. I continue to believe that an appropriate way to determine the differential between the two SC 1 consumption blocks (first 50 therms per month in block 1 and all additional consumption in block 2) is to include the recovery of customer-related A&G expenses in block 1, along with demand-related costs. Block 2 would recover only demand-related costs.

Revised Calculations of Demand-Related Costs and SC 1 Rates

Q. Have you prepared revised calculations that reflect all of the changes you discussed, based on Ms. Grace's rebuttal testimony?

A. Yes, attached as GCI Exhibit 8.1 is a corrected version of Ms. Grace's NS-PGL Ex. 28.1. I then use the demand cost to be recovered in base rates as the starting point for revised versions of GCI Ex. 3.9 (PGL) and 3.10 (NS). I provide those revised versions as GCI Exhibits 8.2 and 8.3, respectively.

Q. What changes are reflected on GCI Ex. 8.2 and 8.3, compared to GCI Ex. 3.9 and 3.10?

A. Page 1 of the revised exhibits uses the demand costs to be recovered in base rates that I developed on GCI Ex.8.1 (line 1) and removes my proposed reallocation of A&G O&M (line 2). On line 4, I am now using annual therms instead of winter therms. On lines 6, 8, and 10, I reduce the amount of customer costs and uncollectible costs to reflect the EPECM factor (98.6%). On page 2 of the revised exhibits, the calculations remain the same, except I have revised the customer charge calculation so that the customer charge will not be reduced from the current level. I did this to mitigate the impact on moderate-use customers of the increase in the first-block charge that would result from this revised approach.

Q. How would bill impacts under your revised rates compare to those under the Companies' proposal?

A. For Peoples Gas, SC 1 customers who use less than 47 therms per month would see lower bills under my proposal than they would under Peoples Gas's proposed rates. Customers whose usage does not get into the second block (more than 50 therms) would pay essentially the same (a difference of $0.07 per month at 50 therms) or less than they would pay under PGL's proposed rates, depending on their usage levels. The biggest impact would be seen by very low use customers whose bills would be much lower under my proposal than under Peoples Gas's proposal. Very large users (more than about 550 therms per month) would see bill increases under my proposal, while they would have had bill decreases under Peoples Gas's proposal.

For North Shore, the effects are similar. SC 1 customers who use less than 102 therms per month would see lower bills under my proposal than under North Shore's proposed rates. Thus only the very highest users would be adversely affected by my proposal because they would lose the benefit of North Shore's proposed rate reduction for those largest users.

Calculation of Fixed Cost Recovery

Q. On page 5 of her rebuttal, Ms. Grace states that Peoples Gas is proposing to recover 62% of its fixed costs through the SC 1 customer charge and North Shore is proposing to recover 69% of its fixed costs through its SC 1 customer charge. Is this accurate?

A. No, this is not an accurate statement. Ms. Grace's calculation includes all storage-related costs as so-called "fixed" costs, even though the Companies are proposing to remove those costs from base rates and recover them through a separate rider. These costs are substantial (more than $30 million for Peoples and about $1.5 million for North Shore) and are not fixed costs. The Companies have properly proposed to recover these costs through a volumetric charge because storage costs are directly related to the amount of gas each residential customer uses. Further, recovering these costs on a volumetric basis is required because these costs are not fixed. For example, the Companies may have the ability to sell unused storage capacity to energy marketers or others who need to store natural gas. So the less storage that is demanded by sales customers, the more storage becomes available for sale to others. The Companies recognize this, as I discussed above, in the design of their proposed Rider SSC which recovers storage-related costs from SC 1 sales customers in proportion to each SC 1 customer's consumption of gas.

Q. Have you prepared a calculation that shows the actual fixed-cost recovery proposed by the Companies?

A. Yes, GCI Exhibit 8.4 shows Ms. Grace's calculation of fixed-cost recovery and then I show a corrected calculation that removes storage-related costs. As I show on that exhibit, Peoples Gas actually is proposing to recover 67% of its total base rate cost of serving SC 1 customers through the customer charge, while North Shore actually is proposing to recover 71% of its total base rate cost of serving SC 1 customers through its customer charge.

Moreover, even this calculation understates the level of the revenue certainty achieved under the Companies' proposal. In particular, it must be recognized that revenues recovered through the first consumption block (the first 50 therms per month) are extremely constant: the Companies exhibit very little change in consumption in this first block. GCI Exhibit 8.5 compares the Companies' sales forecasts from their 2009 rate cases and this case. It can be seen that the difference in first-block consumption is quite small and accounts for only about 25% of the projected change in consumption.

Thus, if we add revenues recovered through the first block charge to those recovered through the customer charge, it can be seen on GCI Ex. 8.4 that the Companies' proposal would result in essentially guaranteed recovery of 88% of SC 1 revenues for Peoples Gas and 90% of SC 1 revenues for North Shore.

These are extraordinarily high percentages, particularly because not all of these costs are "fixed." For example, included in the cost of service are payroll costs, yet the Companies routinely make decisions about whether to hire new employees, replace those who have retired, pay overtime, incur costs for training, and so on. Such costs do not meet any economic or practical definition of being "fixed."

Q. Would a rate design, such as your proposed rate design, that results in a lower recovery of costs through fixed charges be unreasonable?

A. No. My revised rates would recover storage-related costs through Rider SSC, as would the Companies' proposal. This removes such costs from base rates and makes them irrelevant to the issue of cost recovery.

My revised rates then recover the remaining (non-storage) demand-related costs through volume-based charges, which is fully consistent with cost causation. By doing so, it ensures that rates send an appropriate price signal to those customers who effectively cause facilities to be enlarged to meet their greater demand for gas. If rates are not set in this manner, then customers would have the mistaken belief that their increased use of gas has no effect on the costs of the distribution network. That is absolutely false. When customers increase their demand for gas, it leads the Companies to install larger pipes, valves, regulators, and other facilities. Indeed, each time a facility must be replaced, the Companies must consider the likely demands to be placed on the facility in the future. If rates do not send that price signal to customers – that increased demand leads to increased costs – then an essential signal that customers should reduce demand (and thereby control the cost of facilities) is lost. My proposed SC 1 rate design recognizes this fact, while the Companies' proposal ignores it.

Moreover, my proposed rates are designed to enable the Companies to recover their costs. Under my proposed rate design, demand-related costs, including storage costs, are recovered in proportion to gas consumption. A&G costs are recovered through the first consumption block, which is unlikely to vary significantly based on weather conditions. All other costs are recovered through the customer charge which, again, will not vary with weather conditions. Thus, my proposed rates are consistent with the Companies' own cost studies and their apparent goal of ensuring a relatively stable stream of revenues to the utilities.

Q. Have you calculated the percentage of SC 1 base rate revenues that would be recovered through the customer charge and block 1 charge under your proposed rate design, using the Companies' proposed revenue requirement?

A. Yes, on GCI Exhibit 8.6, I show the calculation of the percentage of SC 1 revenues recovered through the customer charge and first block charge under present rates, the Companies' proposed rates, and my proposed rates. The exhibit shows that my proposal would recover in excess of 80% of the total SC 1 revenue requirements for both Companies through the customer charge and first block charge, as is the case under present rates. Moreover, my revised proposal recovers these revenues in a manner that is much fairer to low-use residential customers than is the Companies' proposal.

Response to NS-PGL Witness Hoffman Malueg

Q. Earlier you explained that Ms. Grace did not understand that your direct testimony related solely to residential rate design. Does Ms. Hoffman Malueg have the same misunderstanding?

A. Yes, she does. As I explained above, my direct testimony was limited to residential rate design; I did not make changes in the ECOSS. She is correct, of course, when she states on page 5 that rate design should be consistent with the cost-of-service study. That is precisely my point. The ECOSS shows that millions of dollars of costs are related to customer demand, and Ms. Hoffman Malueg acknowledges that many such facilities are "sized to meet customers' demands" (page 15). But the Companies' proposed SC 1 rate design does not appropriately account for differences in customers' demand; instead they would charge all SC 1 customers essentially the same amount for such demand-related costs, regardless of the amount of gas consumed. As I have explained, that is not consistent with establishing cost-based rates and it is grossly unfair to lower-use customers.

Q. Does this conclude your rebuttal testimony?

A. Yes.